

NATIONAL FORECAST DESCRIPTION

The Forecast Period is the Fourth Quarter of 2003 through the Fourth Quarter of 2007

A look at both the previous and current forecasts reveals several similarities. Most notably, both show the economy enjoying healthy growth over the forecast period. In fact, changes to most of the aggregate economic measures since November suggest the U.S. economic outlook has improved slightly. This can be seen in the GDP forecast. In the November 2003 forecast, it was predicted real GDP would advance an average of 3.6% annually over the 2003-2007 period. This is slightly faster than the estimated full-employment growth of 3.4% per year. The current forecast for real output is more bullish than the previous one; it averages 3.8% over the forecast period. This improvement reflects slightly stronger nominal GDP growth (5.5% versus 5.4%) and lower inflation (1.7% versus 1.8%). Based on these numbers one can reasonably conclude an already healthy forecast has been upgraded. These numbers tell most of the story, but not the whole story.

Nonfarm employment remains a concern. Indeed, Global Insight has lowered its expectations for job growth in the current forecast compared to the previous one. Last November U.S. nonfarm employment was anticipated to advance 1.3% annually over the forecast period. While this is well below its performance in the late 1990s, it is a welcome change from the malaise during 2001 to 2003. Nonfarm employment is currently projected to rise just 1.2% yearly over the forecast period. This change is consistent with recent employment history. The U.S. Department of Labor reported nonfarm employment rose 126,000 in October 2003. At the same time, the estimates for the previous two months had been revised upwards. This convinced many economists the long-awaited job recovery was finally under way. Unfortunately, this good news was followed by a series of disappointing reports that forced economists to rethink their forecasts.

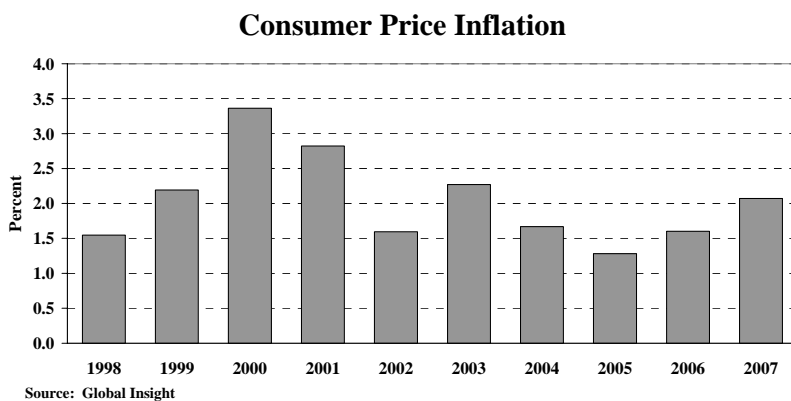
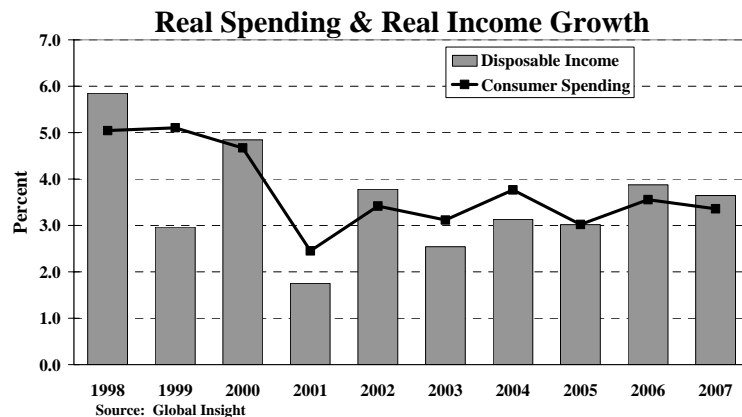
The most recent Department of Labor report has raised hopes once again the job recovery is under way. Nonfarm payroll employment grew by 308,000 in March 2004. Also noteworthy, was the original estimates for March and February were revised up a combined 87,000 jobs. Previous to these revisions, the three-month average increase was a disappointing 42,000. The strong March numbers and revised February numbers bring the first quarter average to a healthy 171,000. This is good news. However, it remains to be seen how, or if, it is incorporated into future forecasts. Having been burned by last fall's false start, most economists are expected to proceed with cautious optimism.

In summary, the overall economy is expected to perform above average over the forecast period. Under most circumstances current conditions would be close to perfect. Output is high, while inflation is low. But concerns over employment have cast a shadow over the economy. But these concerns need to be kept in perspective. We remain confident the economy is once again generating jobs. However, it is harder to determine the number of jobs that will be created over the forecast period. After experiencing a winter's worth of disappointing employment news, the jobs forecast was reduced slightly compared to the previous prediction.

SELECTED NATIONAL ECONOMIC INDICATORS

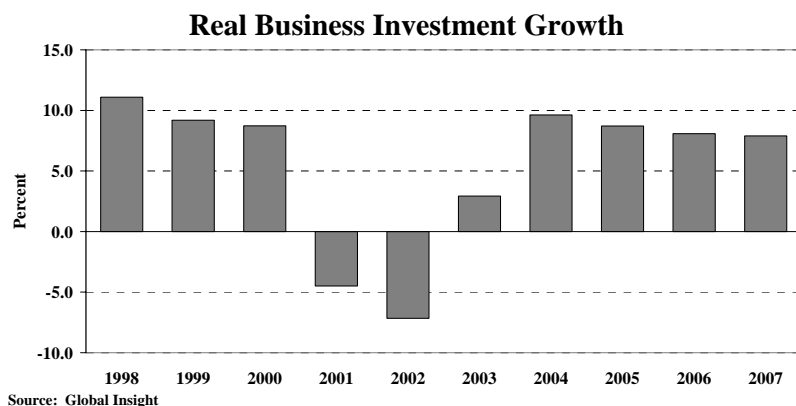
Consumer Spending: Thirteen should be a lucky number for the U.S. economy. This is because the current consumer-spending spree is in its thirteenth year, with no signs of letting up. The forecast of continued spending is welcomed news not only because consumer spending is the largest component of the economy, but it is also the sector that kept the 2001 recession from being more severe than it could have been. Traditionally, recessions are caused

by a decline in consumer spending. One needs only to look to the 1990-91 recession to see an example of this. During that slowdown real GDP retreated in the last quarter of 1990 and the first quarter of 1991. Real consumer spending also declined in these two quarters. Consumer spending has expanded in each quarter since then, except for the last quarter of 1991. This growth helped keep the 2001 recession in check. Since 1945, the average peacetime recessions averaged 10 months in length. The 2001 recession, at just 8 months, was much shorter than the average. The decline in real GDP during the 2001 recession was not as steep as usual. Much of the recent spending growth reflects the rare synchronization of fiscal and monetary policies. The accommodative Federal Reserve has helped keep interest rates low and generous federal tax changes have temporarily boosted consumer disposable personal income. However, the biggest impacts from these policies have already been felt, and continued spending will require another fuel source. This forecast assumes job growth will be this fuel. Over the forecast period real disposable income will serve as the speed limit for real consumer spending growth. In fact, for the first time in several years American consumers are expected to live within their means, with income growing faster than spending. Specifically, real consumer spending is expected to increase 3.1% in 2003, 3.8% in 2004, 3.0% in 2005, 3.6% in 2006, and 3.4% in 2007. As a result of this unaccustomed thriftiness, and after testing limits for several years, consumers' personal finances should improve. For example, the percent of disposable income needed to meet monthly financial obligations was 18.4% in 2003. It is expected to dip just below 18% this year and remain there through 2007. Another sign of improved household finances is the forecasted decline of the personal bankruptcies per thousand adults from 7.2 in 2003 to 4.4 in 2007. Other evidence consumers will be better with credit is the projected decline in percent of credit card accounts that are over due for 30 or more days from 4.3% in 2003 to 3.9% in 2007. Admittedly this is a minor change, but it is a change in the right direction.



Inflation: It is not hard to make a case for tame inflation, despite several factors that suggest otherwise. Recently, inflation alarms have been sounded because of three major factors. They are the sharp rise in commodity prices, the fall of the dollar, and the synchronized global economic recovery. It is true that over the last few weeks prices for steel

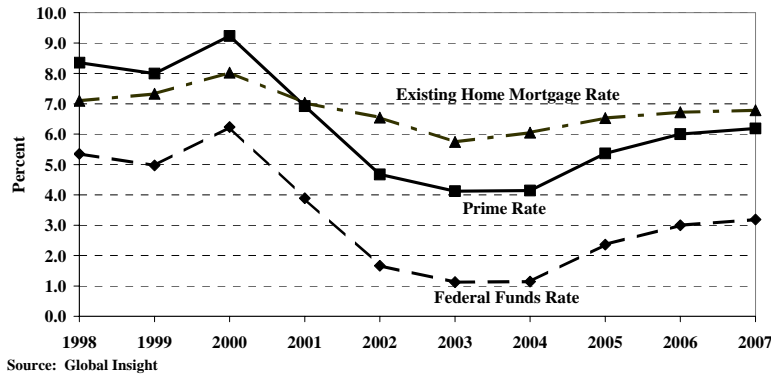
scrap is up 80%, ethylene is up 30%, lumber is up 26%, nonferrous metals are up 22%, and oil is up 17%. Except for oil, none of these price increases have yet found their way to the consumer level, and it is unlikely they will. One of the reasons for this is commodity prices are near their summit. This is because commodity markets traditionally self-correct. Higher commodity prices will increase the production of these commodities, increasing the market supply. At the same time, worldwide industrial production may be flattening, suggesting a weaker demand for commodities. This combination of increased supply and softer demand suggest weaker, not stronger, price increases down the road. Another reason the recent commodity price increases will have a limited impact at the consumer level is because most commodity price moves are absorbed in margins. It has been estimated less than 10% of any move in commodity prices end up in finished good prices, and less than 3% flow to consumer prices. It should also be pointed out that the sector most affected by the commodity increases is manufacturing. In the U.S. manufacturing accounts for about 15% of GDP. With such a limited exposure, commodity prices would have to rise by a large amount and over a long time before their impacts would register in the GDP deflator or the consumer price index. Neither is the falling dollar cause for alarm. While it is true the dollar's decline is inflationary in the short term, its impacts will be limited. This is because many Asian currency values remain tied to the U.S. dollar. This is why import prices from newly industrialized Asian countries were actually down 1.3% recently, while import prices from the European Union were up over 4.0%. Consumer prices will also be held down by weak labor markets. Employee compensation has a huge influence on consumer prices. Over the forecast, employee compensation should rise slowly because of the recovering employment market. With employee compensation expected to rise less than 4.0% annually, cost pressures should be slow to develop, so inflation should remain tame. For example, the consumer price index is forecast to rise 2.3% in 2003, 1.7% in 2004, 1.3% in 2005, 1.6% in 2006, and 2.1% in 2007.



Business Investment: Business investment is now firmly in place. In 2003, real business investment increased 2.9%, which was a huge reversal from the 7.2% decline it posted in 2002. All of last year's gain was due to spending on equipment. The growth leader was the equipment and software category that advanced 5.5%. Fueling this expansion was the nearly 14% increase in information and processing equipment, which benefited from the 32.6% increase in computer spending.

Investment in nonresidential structures fell for the third straight year in 2003. The forecast calls for business investment to grow continuously over the next few years, with growth accelerating this year then tapering off thereafter. Specifically, real business investment is expected to advance a healthy 9.6% in 2004, 8.7% in 2005, 8.1% in 2006, and 7.9% in 2007. As was the case in 2003, most of the growth will be in the equipment and software category. In fact, structures are expected to be a drag on investment until 2005, when it posts its first gain of the millennium. Capital spending by the manufacturing sector is also expected to return. The manufacturing sector has kept its traditional capital spending to a "bare bones" minimum in recent years. In fact, since 2000, real investment in industrial equipment has declined an average 6.2% annually. While excess capacity still remains the rule rather than the exception, much of the traditional equipment is beginning to show signs of age and is in need of replacement. Combining this age issue with this year's expected higher manufacturing output suggest the first spending increase in three years.

Selected Interest Rates

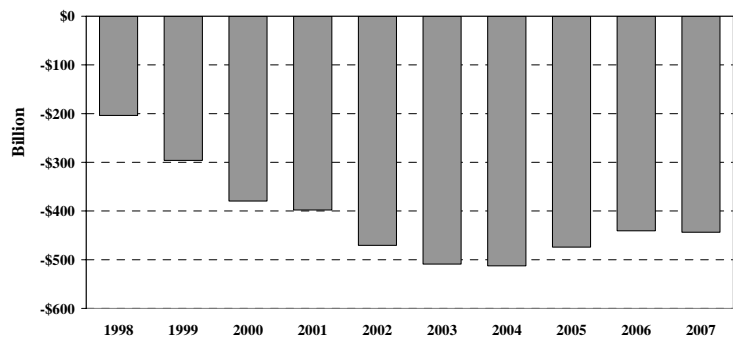


Financial: The lack of policy action by the Federal Reserve may leave some wondering whether the nation's central bank is cruising on autopilot. The fact of the matter is the Federal Reserve is hard at work staying the course with a policy that demands no quick changes at this point. This begs the question what will be the Federal Reserve's next move and when will it take place. This forecast assumes the Federal Reserve will raise its bellwether

federal funds rate by 25 basis points in August. This would mark the first in a series of hikes that will take the federal funds rate to about 3.2% in 2007. There are several reasons why this is believed to be the central bank's most likely course of action. First, with the federal funds rate already at 1.0%, there is little room for it to lower this rate further. The second reason to raise rates down the road is because, except for employment, the U.S. economy is doing relatively well, so it does not need lower interest rates. The Federal Reserve is very sensitive to the weak job picture, and will not raise rates until job growth reaches about 200,000 jobs per month. Any tightening before that risks usurping the nascent job recovery. Fortunately, the current low-inflation environment is providing the central bank the luxury of time until it needs to move again. One factor that will complicate the Federal Reserve's decision making is this fall's presidential election. Traditionally, as a gesture of its political independence, the Federal Reserve does not like to change rates too close to an election. As a result, the Federal Reserve must act in August, or it could find itself running out of time to act before the election.

International: The U.S. is expected to grow faster than the world economy over the next couple of years. As the engine for economic growth, the U.S. could see its current trade deficit explode because its markets will remain the target for goods from less-fortunate countries trying to export themselves to prosperity. However, the weaker dollar will help the competitiveness of American goods and services in the global market, preventing the current account deficit from bulging too far from current levels. Before going into more detail about the current account

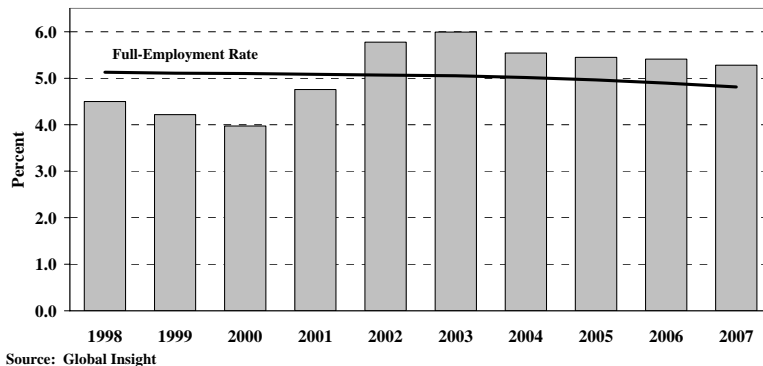
Real U.S. Trade Deficit



deficit from bulging too far from current levels. Before going into more detail about the current account deficit, it is a good idea to review the prognosis of some of America's leading trade partners. Although the U.S. economy will enjoy above-average growth over the next two years, it will not be the strongest growing economy. Asia except for Japan will post the fastest relative growth. This fast growing region should see its collective GDP rise by 6.2% in 2003, by 6.5% in 2004, and by 6.0% in 2005. China is expected to be the top performer in this group, turning in 8.0% growth this year after expanding 9.1% last year. Japan remains the exception to strong Asian growth. Japan should enjoy back-to-back economic growth of over 2.0% for the first time since 1991 in 2003 and 2004. The European economy will also face challenges. First, the rise of the euro compared to the dollar will hurt European exports at a time Europe is overly dependent on exports. Second, soft consumer spending will hurt growth on the continent. Closer to home, both Canada and Mexico are forecast to grow slower than the U.S. These factors suggest America's current account balance will not improve over the forecast period. However, the situation would be worse if not for the declining dollar. All things being equal, the decline in the

dollar makes U.S.-produced goods and services less expensive than the foreign counterparts. As a result, fewer foreign imports are sold in the U.S. while more American products are sold abroad. This would shrink the nation's already huge current accounts deficit. According to the current forecast, the U.S. dollar's value will continue declining over the forecast period. Unfortunately, an improvement in the current account deficit is still a ways off. It is estimated the current account deficit was \$548.9 billion last year. It is expected to rise to \$575.0 billion this year, and remain near this level through 2006, before increasing to \$615.5 billion in 2007.

U.S. Civilian Unemployment Rate



Employment: The actual path for the economy will depend on how the employment picture develops over the forecast period. This forecast assumes employment will heat up just as the stimulative impacts of the temporary tax cuts ebb. This must take place in order for the current expansion to proceed unhampered. Should the job recovery fail to materialize, consumer spending will be threatened, and this would put the

current expansion at risk. Because the stakes are so high, each of the U.S. Department of Labor's monthly *Employment Situations* is eagerly anticipated. Based on these reports, the outlook for U.S. employment is cautiously optimistic. The mood was slightly more positive late last year when the January 2004 *Idaho Economic Forecast* was being put together. Last year it was predicted that after a long drought, employment would pick up in the second half of 2003, and the employment data suggested this was taking place. In its November 2003 press release, the U.S. Department of Labor reported the U.S. seasonally adjusted unemployment rate had declined to 6.0% in October 2003 from 6.1% the previous month. The same report also estimated the number of jobs increased 126,000 in October 2003. This was a welcomed change from the job losses that stretched back to early 2001. It was believed this was the first in a series of positive employment reports. Unfortunately, it was not. What followed was a string of disappointing reports that showed actual employment growth was under projections. The low point occurred when key economic advisors to the President distanced themselves from the Administration's official employment forecast published in the *Economic Report of the President*. However, like last year, the positive March 2004 *Economic Situation* has raised hopes again that a sustained employment recovery is under way. After several months of lackluster gains, U.S. nonfarm employment posted a surprisingly strong 308,000 net job gain in March 2004. Seventy-eight thousand jobs were created in the goods-producing sector and the remainder were created in the services-producing sector. Interestingly, the manufacturing sector netted no new jobs. This can be seen as good or bad. On the downside, this marks another in a long string of months manufacturing has not generated any new jobs. But on the other hand, this marks the first time in a long while it has not lost any jobs. At worst, it is a welcome respite from the 46 months of losses that cost this sector nearly 3 million jobs. At its best it marks the end of this battered sector's long slide. Of course, one month does not make a trend, so Department of Labor reports will continue to receive more-than-usual scrutiny until employment growth is back on a solid footing. The current U.S. economic forecast shows employment growth accelerating this year from 0.5% in the first quarter to 2.2% during the last quarter. Virtually all of this growth will be in the services-producing sector, while contributions from the goods-producing sector are not expected until the beginning of next year. The manufacturing sector is expected to post a small net job gain in the second quarter of this year, but this year will prove disappointing. However, it should commence several years of growth beginning early next year.

Overall, U.S. nonfarm employment should decline 0.3% in 2003, rise 0.8% in 2004, 2.0% in 2005, 1.8% in 2006, and 1.6% in 2007.

Government: Braking the runaway deficit will be one of the biggest domestic policy challenges faced by the President and Congress. Soon after the fall election, the President and Congress will have to deal with the swelling federal budget deficit. According to the Congressional Budget Office, the federal budget deficit will hover in the \$500 billion range for several years. Looked at another way, during the 5-year period from fiscal year 2005 to fiscal year 2009, these deficits are projected to add up to nearly \$1.5 trillion. This is a major change from a few years ago when the federal budget was in surplus and the outlook called for several years of surpluses. Unfortunately, the administrative and legislative branches will find they have limited options for dealing with the deficits. One way is to limit spending. Spending is now 20% of GDP, and it is unlikely it can be squeezed further. Another hope is prosperity will fix the deficit problem by raising federal receipts. Some suggest receipts can be brought back to the 21% of GDP realized in 2000. This appears unrealistic. In 2000, capital gains accounted for slightly more than 10% of adjusted gross income, which was significantly more than the typical 2-4% share. Historically, any time personal tax receipts have climbed above 10% of personal income, pressure has built for tax cuts. Relative to GDP, the long-run average share of personal federal taxes is 8.2%, with a peak of 10.4% in 2000, and a current share of 6.9%. Another option is lowering the outlay share of GDP, but this seems unlikely given the rising cost of entitlements. One politically unpleasant option is to raise taxes. But any serious discussions to do this will be delayed until after the election.